The Commonwealth of Massachusetts

DEPARTMENT OF
TELECOMMUNICATIONS AND ENERGY

D.T.E. 05-48 October 31, 2005

Petition of Bay State Gas Company for Approval of Firm Transportation and Related Agreements with TransCanada Pipelines Limited and Union Gas Limited.

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I. INTRODUCTION

On July 13, 2005, Bay State Gas Company ("Bay State" or "Company"), pursuant to G.L. c. 164, § 94 A, filed a petition with the Department of Telecommunications and Energy ("Department") for approval of a firm transportation agreement and related agreements with Union Gas Limited ("Union")[1] and TransCanada Pipelines Limited ("Trans Canada").[2] On August 16, 2005, pursuant to notice duly issued, the Department held a public hearing to afford interested persons the opportunity to comment on the Company's petition. The Attorney General of the Commonwealth ("Attorney General") was granted leave to intervene as of right, pursuant to G.L. c. 164, § 11 E, and KeySpan Energy Delivery New England was granted limited participant status.

On September 27, 2005, the Department held an evidentiary hearing. The Company presented the testimony of Francisco C. DaFonte, director of energy supply services for the Company. The evidentiary record consists of 46 exhibits. The Company and the Attorney General filed initial briefs on October 4, 2005. The Company filed a reply brief on October 7, 2005.

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1 Union, a wholly-owned subsidiary of Duke Energy Company, provides distribution services for the Province of Ontario, as well as transportation and natural gas storage services for the Northeastern United States and the Provinces of Ontario and Quebec (Exhs. BSG-1, at exh. FCD-3; AG 1-5).

2 TransCanada owns and operates approximately 25,600 miles of natural gas pipeline extending from the border of the Provinces of Alberta and Saskatchewan into the Province of Quebec, with branch pipelines extending to Canadian-United States border (Exh. BSG-1, at exh. FCD-4, at 1).

II. DESCRIPTION OF THE PROPOSED AGREEMENTS

A. The Union Agreements

The Company states that it entered into a firm transportation agreement and a financial backstopping agreement (collectively, the "Union Agreement") with Union for capacity to allow the Company to access less costly pipeline and storage supplies at the Dawn trading hub in Ontario, Canada (Exh. BSG-1, at 3). Specifically, under the Union Agreement, Bay State will contract with Union for mainline capacity pursuant to the recourse rate under Union's rate schedule M12 for a term of eleven years commencing on or about November 1, 2006 (Exhs. BSG-1, at 8; BSG-1, at exhs. FCD-2; FCD-3). The maximum daily quantity ("MDQ") under the Union Agreement is 26,352 dekatherms ("Dth") with a primary receipt point at Dawn, Ontario, Canada, and a primary delivery point at Union's interconnection point with TransCanada's facilities located at the Parkway compression station in Milton, Ontario, Canada (Exh. BSG-1, at 8).

In order for this project to take place, Union must construct (1) a 18.2 kilometer 48-inch pipeline and (2) a 17.1 kilometer 48-inch pipeline, both in Ontario, Canada (Exh. AG 1-14). In addition to the new pipelines, Union will also need to upgrade an existing compressor at Parkway and install more compression at its Dawn compressor station (id.). Bay State represents that Union received regulatory approval from the Ontario Energy Board ("OEB") for these infrastructure improvements on July 6, 2005, and construction is expected to commence in Spring 2006 (id.). Union will both own and operate these new facilities (id.).

Under the Union Agreement, Bay State is exposed to financial liability pursuant to a financial backstopping agreement if the Company fails to satisfy or waive conditions subject to its control (Exh. BSG-1, at 10; Tr. at 9-10). Specifically, Bay State must: (1) enter into the necessary contracts with Union to facilitate the transportation services contemplated in the Union Agreement; and (2) receive all internal and external regulatory approvals for the Union Agreement (e.g., approval from the Department) (Exh. BSG-1, at 10-11; Tr. at 9). The financial backstopping agreement ensures that Union does not bear 100 percent of the risk associated with the financial responsibility for constructing a pipeline without a financial commitment from Bay State (id.; Tr. at 33). The Company notes that because the Union and TransCanada pipeline construction projects are "fully subscribed," a replacement local distribution company ("LDC") could be readily substituted, which would relieve Bay State of many of its financial obligations (id.). In other words, in the event that Bay State cannot fulfill its obligations under the Union Agreement and withdraws from the Agreement, Union has a queue of potential buyers waiting to purchase transportation service that cannot presently do so because Union's pipeline is "fully subscribed" (id.).

B. The TransCanada Agreement

The Company states that Bay State entered into a precedent agreement, a shared cost event of cancellation agreement, and a financial assurances agreement (collectively, the "TransCanada Agreement"). Specifically, Bay State will contract with TransCanada for mainline capacity under TransCanada's firm transportation service toll schedule for a ten-year term commencing on or about November 1, 2006 (Exhs. BSG-1, at 8; BSG-1, at exhs. FCD-5 (confidential); FCD-6). The MDQ under the TransCanada Agreement is 26,063 Dth, with a primary receipt point for gas at TransCanada's interconnection with the facilities of Union at the Parkway compression station in Milton, Ontario, Canada, and a primary delivery point at TransCanada's interconnection with Iroquois Gas Transmission's facilities at Waddington, New York (id.).

Similar to the Union infrastructure construction and improvements, TransCanada will likewise need to construct two pipelines in Ontario: (1) 18.1 kilometers of 42-inch pipeline and (2) 19.7 kilometers of 42-inch pipeline (Exh. AG 1-16). TransCanada filed the pipeline construction project with the Canadian National Energy Board on September 16, 2005, and construction is expected to commence in Spring 2006 (id.). TransCanada will both own and operate these pipelines (id.).

Under the TransCanada Agreement (similar to the Union Agreement, noted above), Bay State must make a financial commitment to TransCanada to ensure the Company's financial commitment for the pipeline's construction (Exh. BSG-1, at 12; Tr. at 33-34). Therefore, should Bay State seek to cancel the pipeline construction project (e.g., due to failure to obtain approval by the Department of the TransCanada and Union Agreements), and thus trigger the event of cancellation contract, Bay State would be contractually responsible for a portion of the cost of pipeline construction (id.). The financial assurances agreement and the event of cancellation agreement ensure that TransCanada does not bear 100 percent of the risk associated with the financial responsibility for constructing a pipeline without a financial commitment from Bay State (id.; Tr. at 33). However, TransCanada is also contractually obligated to mitigate the expenses that Bay State would incur should the Company fail to ultimately proceed with the TransCanada Agreement (Tr. at 34). The Company notes that because the Union and TransCanada pipeline construction projects are "fully subscribed," a replacement LDC could be readily found, which would relieve Bay State of many of its financial obligations (id.).

III. STANDARD OF REVIEW

In evaluating a gas utility's resource options for the acquisition of commodity resources as well as for the acquisition of capacity under G.L. c. 164, § 94A, the Department examines whether the acquisition of the resource is consistent with the public interest. Commonwealth Gas Company, D.P.U. 94-174-A at 27 (1996). In order to demonstrate that the proposed acquisition of a resource that provides commodity and/or incremental resources is consistent with the public interest, a local gas distribution company ("LDC") must show that the acquisition (1) is consistent with the company's portfolio objectives and (2) compares favorably to the range of alternative options reasonably available to the company at the time of the acquisition or contract negotiation. Id.

In establishing that a resource is consistent with the company's portfolio objectives, the company may refer to the portfolio objectives established in a recently approved forecast and requirements plan or in a recent review of supply contracts under G.L. c. 164, § 94A, or may describe its objectives in the filing accompanying the resource proposal. Id. In comparing the proposed resource acquisition to current market offerings, the Department examines relevant price and non-price attributes of each contract to ensure a contribution to the strength of the overall supply portfolio. Id. at 28. As part of the review of price and non-price attributes, the Department considers whether the pricing terms are competitive with those of the broad range of capacity, storage, and commodity options that were available to the LDC at the time of the acquisition, as well as those opportunities that were available to other LDCs in the region. Id. In addition, the Department determines whether the acquisition satisfies the LDC's non-price objectives, including, but not limited to, flexibility of nominations and reliability and diversity of supplies. Id. at 29.

IV. POSITIONS OF THE PARTIES

A. Bay State

In order to demonstrate that the Union and TransCanada Agreements are in the public interest, Bay State must show that the capacity Agreements are consistent with the Company's portfolio objectives (Bay State Brief at 7). Thus, Bay State argues that the Union and TransCanada Agreements are consistent with the Company's portfolio objectives because the Agreements contribute to the Company's goal of developing a best-cost portfolio (id.; Exh. BSG-1, at 22, citing Bay State Gas Company, D.T.E. 02-75, at 35 (2004)). The Company further argues that it seeks to acquire and manage resources that achieve a best-cost resource portfolio for Bay State's customers, while simultaneously balancing cost with non-cost criteria such as reliability, flexibility, and viability (id.). Bay State maintains that its ultimate goal is to achieve adequate and reliable service at a reasonable cost (id.).

Bay State argues that the Department has previously reviewed and approved its planning objectives and methods in forecast and supply plans, as well as requests for approval of specific resource decisions (id. at 9, citing D.T.E. 02-75; Bay State Gas Company, D.T.E. 03-32 (2003); Bay State Gas Company, D.T.E. 02-52 (2002); Bay State Gas Company, D.T.E. 00-52 (2002). Further, Bay State asserts that it has consistently worked to develop a "'best-cost'" portfolio (id., citing D.T.E. 03-32. Therefore, Bay State argues that, as the Department has previously determined that the Company's portfolio objectives and its resource acquisition process were appropriate and reasonable, and because those practices were followed in the instant petition, the first criterion of the Department's standard has been met (i.e., consistency with the Company's portfolio objectives) (id. at 9).

In addition to demonstrating that the Union and TransCanada Agreements are in the public interest by being consistent with its portfolio objections, the Company must also show that these Agreements compare favorably to reasonable alternatives available to Bay State. Thus, Bay State notes that it performed cost simulations using its "SENDOUT®"[3] model for an eleven-year test period beginning November 1, 2006 (id. at 10). The available alternative is the Company's current practice of spot-purchasing at the Waddington, New York-Ontario border (id.). Bay State contends that the SENDOUT® model affirmed that the Union and TransCanada Agreements were superior to the Company's existing border spot-purchases at Waddington, New York (id., citing Exhs. BSG-1, at 26; BSG-1, at exhs. FCD-10 (confidential) at 37; FCD-11 (confidential); FCD-12 (confidential)). The Company asserts that the Union and TransCanada Agreements would result in a total portfolio cost of

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[3] The SENDOUT® optimization model used by Bay State evaluates the cost effect of changes to the Company's portfolio by simulating the daily dispatch of available resources under specified conditions (Exh. BSG-1, at 21).

$3,713,933,000, compared to the Waddington portfolio cost of $3,723,831,000 (id.). Bay State argues that the Union and TransCanada Agreements would result in a total portfolio savings over the eleven-year period of $9,897,640 (id., citing Exh. BSG-1, at 26). Hence, Bay State argues that its proposed Union and TransCanada Agreements compare favorably to the alternative of spot-purchasing at Waddington, New York (id.).

Next, the Company must demonstrate that, when examined on a price and non-price basis, the attributes of the Union and TransCanada Agreements ensure a contribution to the strength of Bay State's overall supply portfolio. Regarding the non-cost attributes of the proposed Union and TransCanada Agreements, Bay State asserts that it specifically considered the following: reliability, flexibility, and viability (Bay State Brief at 11). The Company argues that the Union and TransCanada Agreements were superior to other options because they provide diversification of supply by providing the Company with access to the Dawn trading hub in Ontario, Canada (id. at 12, citing BSG-1, at exhs. FCD-14; BSG-1, at 27-29). Specifically, at Dawn, Bay State will have access to seven upstream pipelines transporting gas supply from Canada, the Midwest, the Gulf Coast, the Permian Basin, the Rockies, the Chicago market, and Michigan storage supplies (id.). Bay State explains that Waddington, the location where the Company currently obtains supply, does not provide flexibility, liquidity, or diversity because of a lack of both suppliers and storage (id., citing Exh. BSG-1, at 27).

Regarding the Attorney General's comments that Bay State's Agreements expose its customers to substantial financial liability, the Company responds that its customers' financial liability would be limited to pre-engineering (i.e., pre-construction), legal, and administrative costs that do not come close to the maximum potential liability (Bay State Reply Brief at 2). The Company notes that the parties are legally obligated to mitigate cancellation expenses to the extent possible, and that because the projects are fully subscribed, a replacement LDC could be readily substituted (id.). Moreover, the Company argues that any cancellation charges that its customers could potentially pay would have to be first approved by the Department after investigation in a cost of gas adjustment filing (id. at 3).

Bay State also argues that the Department has approved capacity contracts with similar financial cancellation charges, despite the Attorney General's argument to the contrary (id. at 1-2, citing KeySpan Energy Delivery, D.T.E. 02-18 (2002)). Last, the Company also asserts that should Bay State not pursue these Agreements, its customers would be at greater risk because the proposed Agreements serve as replacements to Bay State's current spot purchases at Waddington, where prices are volatile. Finally, Bay State concludes that these Agreements will provide significant savings to customers over the next eleven years (id. at 2, citing Exhs. DTE 2-2; DTE 2-3; DTE 2-4(b); DTE 2-6; AG 1-24, BSG-1, at 26).

B. The Attorney General

The Attorney General argues that the Company's proposed Agreements with TransCanada and Union subject Bay State's customers to substantial financial exposure (Attorney General Brief at 2). Moreover, the Attorney General argues that the Department has not approved similar capacity agreements in the past, and that the instant Agreements with Union and TransCanada should, therefore, be rejected (id. at 4). In the alternative, the Attorney General argues that, if the Department approves the Agreements, the Department should not pass any financial losses through to customers, but make the shareholders bear the financial risk (id. at 4-5). Last, the Attorney General asserts his right to challenge the "prudence and usefulness" of the Union and TransCanada Agreements should the Department approve the contracts (id. at 5, citing Consumers Organization for Fair Energy Equity v. D.P.U., 368 Mass. 599 (1975); Boston Gas Company, D.P.U. 93-60, at 24-25 (1993); Attorney General v. Department of Telecommunications and Energy, 438 Mass. 256, 264 n.13 (2002)).

V. ANALYSIS AND FINDINGS

With respect to the Company's portfolio objectives, the Union and TransCanada Agreements contribute to meeting Bay State's stated goal of developing a flexible, diversified, and best-cost portfolio (Exh. BSG-1, at 23-28, 30). For the reasons set out below, the Department finds that Bay State's Agreements with Union and TransCanada are consistent with the portfolio objectives and the supply planning process established in the Company's most recent forecast and supply plan approved by the Department in D.T.E. 02-75 (Exh. DTE 2-3). Bay State's analysis of replacement capacity shows that it requires more flexible resources such as the Union and TransCanada Agreements to ensure system reliability, diversity of supply, and ultimately, cost savings for customers (Exh. BSG-1, at 21; Tr. at 26, 35-36). These Agreements give Bay State access to the Dawn trading hub, which in turn, provides Bay State with access to seven upstream pipelines (Exh. BSG-1, at 27-29; Tr. at 26, 35-36). The evidence further establishes that the long-term Agreements are superior to the Company's current practice of spot-purchasing at Waddington, which is vulnerable to sharp price volatility

(Tr. at 26). The Company has also shown that the Union and TransCanada Agreements compare favorably to alternatives available to the Company and its customers. As demonstrated by the Company's SENDOUT® optimization model, the Union and TransCanada Agreements are superior to Bay State's current spot-purchasing at Waddington (Exhs. BSG-1, at 26; BSG-1, at exhs. FCD-10 (confidential) at 37; FCD-11 (confidential); FCD-12 (confidential)). Hence, the Department finds that the Union and TransCanada Agreements are preferable to Bay State's other alternatives (i.e., spot-purchasing at Waddington) and offer additional savings and reliability to the Company and its customers.

The Department also finds that the TransCanada and Union Agreements provide both price and non-price advantages compared to the alternative resource options available to the Company. As noted above, the Agreements provide access at Dawn to seven pipelines, which ensure greater flexibility, diversity, and price stability. For the same reasons, the Department also finds that the TransCanada and Union Agreements will provide a cost-effective approach to managing required system resources.

The Attorney General argues that the Department should reject the proposed Agreements unless shareholders bear the financial risk (as opposed to ratepayers). The Attorney General bases his concern on the risk of financial exposure in the event of cancellation of the Union and Trans Canada projects. However, the Company demonstrated that negotiated financial liability provisions are commonplace in contracts that require one party to commit capital resources as a collateral in order for the other party to proceed with, as in this case, the construction of pipeline (Tr. at 23-26). The Attorney General has not provided any evidence to establish that the financial liability provisions in the proposed Agreements are a deviation from standard practice in pipeline construction agreements (Attorney General Brief at 4). In fact, the Department has approved contracts with similar provisions. See Bay State Gas Company D.T.E. 03-37 (2003); D.T.E. 02-18. Moreover, in the event that the Agreements did result in financial liability for the Company, it would have to petition the Department, and only after our investigation and approval would Bay State be permitted to recover such costs. In that instance, the Attorney General would be afforded the opportunity to "challenge the prudence and usefulness" of the Agreements. Hence, we reject, as premature and unsubstantiated, the Attorney General's proposal to shift the financial liability risk to shareholders.

In conclusion, for the reasons stated above, the Department finds that Bay State's proposal to enter into long-terms contracts for firm transportation with Union and TransCanada to be in the public interest because the Agreements: (1) comply with the Company's portfolio goals; (2) compare favorably to the range of alternatives reasonably available to the Company; (3) properly evaluate cost and non-cost attributes to ensure that its portfolio is strengthened; and (4) achieve flexibility of nominations, and reliability and diversity of supply. Therefore, the proposed Union and TransCanada Agreements are allowed.

VI. ORDER

After due notice, hearing, and consideration, it is

ORDERED: That Bay State Gas Company's petition for approval of firm transportation agreement and related agreements with Union Gas Limited and TransCanada Pipelines Limited is ALLOWED.

By Order of the Department,

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Paul G. Afonso, Chairman

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Judith F. Judson, Commissioner

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Brian Paul Golden, Commissioner

An appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.